ments about compliance systems have been unwilling to identify liability of
directors. Finally, I stress the duty to respond to red flags.

Debt Equity Swap under Japanese Company Law

Takahiro Matsushima

1 Introduction

Debt Equity Swap (hereafter DES) is a loan workout scheme where the relevant
participating creditors (often only financial creditors) receive equity interests in a
capital restructuring in exchange for debt claims against the company. For a DES,
the Company Act 2005 (hereafter CA) provides for the regulation of contribution
in kind; when a stock company solicits persons to subscribe to shares, relinquish-
ing a money claim (limited to claims that have already fallen due) on the stock
company can be the “properties contributed in kind” (Article 207 (9) (v) of the
CA).

In the case of a DES, the most controversial issue is how to assess the money
claim in terms of face value and fair market value. In a corporate rescue situation,
the latter must be far below the former.

2 The face value and the fair market value theories

There are two theories here—the face value theory and the fair market value
theory. The face value theory emphasizes the following two points:

(1) The value of money claims that have already fallen due should be equal to
their face value.

(2) Through face value (as opposed to fair market value), corporate debt can
be immediately converted to equity, so it is a short cut to cost-effective and
speedy corporate restructuring DES.

The fair market value theorists criticize the face value theory saying that it un-
necessarily dilutes the equity of existing shareholders.

3 Recent Trends in Practice

In 2001, the Tokyo District Court stated that the court shall apply the face
value theory in a DES in accordance with the former Commercial Code (which
was replaced by CA). Its statement affected DES in practice, making the face
value theory in DES the mainstream in Japanese corporate rescues. Some regard
Article 207 (9) (v) of CA as the legalization of the face value theory.

However, there is another stream under the CA. On 28 April 2009, the Tokyo
District Court adopted the fair market value theory under the Corporation Tax
Act despite the face value theory legalized by the CA. Since then, the fair market
value theory has undergone a revival in Japanese DES practice.

4 The Range of Validity of the Face Value Theory in the CA

The aim of this presentation is to mark the validity range of the face value the-
ory in the CA. In my view, the following two points matter.

First, recent trends in the Bankruptcy Law must be considered. Since the estab-
lishment of the Civil Rehabilitation Act, 1999, and the introduction of the American style “debtor-in-possession” scheme, the Bankruptcy Law has become more frequently “out of court,” which should result, all the more, in its mingling with Company Law. This encourages us to expand the application of the face value theory not only to legal bankruptcy procedures but also to “out of court” corporate rescue DES procedures.

My second view is that, the expanded application of the face value theory must not facilitate tax avoidance through DES, however. In my view, the aim of the DES in the case of the Tokyo District Court case of 28 April 2009 was mainly to avoid paying corporate taxes.

To reconcile these two points, this report argues for the following two approaches.

The first one is through “soft laws” and the other is through structured financial methods. The former depends on the content of soft laws, and the latter lacks universality. It remains to be considered further which approach is better.

**Puzzling Issues with the Equality of Shareholders: From the Interpretative Perspective of the Companies Act**

*Toshikazu MURATA*

Concerning the equality of shareholders, it is stipulated in the Article 109 of the Companies Act that a corporation shall treat its shareholders equally in accordance with the features and number of the share they hold. In this article, the individual and general provisions have become concomitant of the equality, thus various interpretative discussions including the relation of both provisions have been performed. Particularly, because the practical and theoretical discussions concerning the defensive measures over the hostile takeover had been activated during a time of the legislation, the establishment of the general provision have caused a great deal of confusion in the interpretation of the equality. Therefore, some scholars challenge the rationality of this article. The purpose of this presentation is to try setting up the way of the concrete interpretation about the equality with careful attention to the correspondence with the overall text composition of the Companies Act.

After enforcing the Companies Act, in the Bull-Dog-Sauce case, the Supreme Court concluded that, in principle, the equality should not be applied to the issue of the option with several discriminatory conditions, but its purport should be applied in terms of the peculiarities of this issue. Moreover, the Supreme Court concluded that, the discriminatory treatment to some stockholders should not constitute a contradiction with the purport as long as it is not against the ideal of equity, and the majority decision of shareholders should ultimately decided whether the corporate value is damaged by the hostile takeover. It is the purport of the equality that was assumed the problem by this decision. Therefore, even if